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SUBJECT: TIGHTENING BELTS, NOT TOURNIQUETS: WESTERN MEXICO AND THE RECESSION

REF: GUADALAJARA 0077

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¶1. Summary: The economy of western Mexico, anchored on the state of Jalisco and the city of Guadalajara, appears to be withstanding the global economic crisis better than many other regions of the country. Key sectors such as agribusiness and high technology have proven to be fairly resilient in the face of financial turbulence, the depreciation of the peso, and ongoing security challenges. Other areas such as real estate, manufacturing, and tourism have been hit harder. Foreign remittances, an important element of the local economy, have fallen less than feared in real terms. The Jalisco State Government is planning a lavish investment program in public infrastructure, partly for political reasons. While the local business community is certainly anxious over ongoing national and world developments, there are no signs of panic. End Summary.

REMITTANCES: Down, But Not Out

¶2. Following a national trend, remittances peaked in 2006 and have been fluctuating around USD\$750 million since, dropping slightly each of the last two years. Though there had been continual slight growth in remittances to the states of Aguascalientes, Colima, Jalisco and Nayarit every year since Banxico began tracking by state in 2003, remittances have been stagnant since the start of 2006. Jalisco, which takes in twice as much as the other three combined, has seen the largest drop, falling 3.3 percent in 2008. Growth has declined in dollar terms, but the recent depreciation of the peso has enabled Mexicans to get more out of each remitted dollar. These funds disproportionately benefit rural areas, which have seen the largest out-migration to the United States. In Jalisco, over 9,000 rural families rely on remittances as their main source of income, with the majority of payments made to parents by their working children. Rising unemployment in the United States is therefore a significant concern for the future stability of remittance payments.

INFRASTRUCTURE: Opening the Public Purse:

¶3. Jalisco's State Government, aided by a record contribution from federal coffers and over USD\$350 million in new public debt, has a wide range of public works projects planned or underway. Many of the projects focus on road improvements and construction, including the completion of the last segment of the Guadalajara beltway, a city by-pass route for trucks, and improvements to the freeway between Guadalajara and Puerto Vallarta. President Calderon joined Jalisco Governor Emilio Gonzalez Marquez on March 10 to inaugurate Guadalajara's first bus rapid transit route and promised funds for several

additional lines. The two leaders also came together to open the second phase of a hydroelectric dam on the Jalisco and Nayarit border. When completed in 2012, the La Yesca dam will be the largest in Western Mexico and should create five thousand direct jobs, with up to an additional fifteen thousand indirect jobs. While the Governor has heavily publicized these investments as an economic stimulus effort, opposition parties claim the surge in spending is also meant to influence this summer's municipal and legislative elections.

MANUFACTURING: Feeling the Pain:

¶4. As in other parts of the country, manufacturing has suffered in the region, with the automotive sector hit particularly hard. Though layoffs have been limited so far, a local factory of around 700 employees creating electronic components for cars recently announced its liquidation in a restructuring effort that will move production to China. In addition, a director of Nissan's Aguascalientes assembly plant told us that to avoid layoffs the company may begin to cut employee work hours; the plant also stopped production temporarily in January. The Honda plant in suburban Guadalajara has also announced plans for a temporary production "holiday." Furniture, another bedrock Jalisco industry, is also showing mixed results. While the number of exhibitors at Guadalajara's National Furniture Show was 11 percent larger this year, and the declining peso makes Mexican furniture more attractive to foreign buyers, the weak US economy is undermining demand in the sector's largest export market. Several furniture producers have experienced financial difficulties as a result. Also hurting are companies that sell imported manufactured goods. TRACSA, the local agent for Caterpillar and other US farm machinery makers, has reported a 20 percent decline in sales over the past six months.

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HIGH TECHNOLOGY: A Bright Spot

¶5. Major players in "Mexico's Silicon Valley" are cautiously optimistic regarding the potential growth of their sector this year. The President of the local Electronics Trade Association (CANIETI) estimated that 15% of the high-tech industry is suffering losses, while another 15% is booming, with the rest more or less stable. Companies associated with the automotive industry are suffering, while those developing software and multimedia technologies, or handling outsourced "back office" operations for foreign companies are doing well. Hewlett Packard, for example, is planning to expand its operations in the latter category this year after acquiring EDS. For the most part, skilled employees in this sector who have been laid off by struggling enterprises have been able to find similar jobs at other high tech firms. The State of Jalisco has also provided financial assistance to attract and support companies in this field, which it views as a motor for future development in the state. With much of this sector's output destined for US buyers, the weak US economy remains a major concern.

REAL ESTATE: A Softening Market

¶6. After a more than ten year boom, the Jalisco real estate market is definitely softening. In Guadalajara, at least three major commercial building projects have been put on hold by developers until they determine what impact the current financial downturn will have for the investors. The city's ambitious plan to build a Latin American branch of the Guggenheim Museum also appears to be dead, given the uncertainty in locating private financing and the need to invest public funds in required infrastructure for the 2011 Pan American Games. These decisions have had ripple effects in the construction and labor markets, with a reduction in employment

opportunities. On the residential side, the Consulate is finally seeing lower rents after more than ten years of increases and tough bargaining with landlords. Sales prices are also declining, but in a gradual rather than abrupt manner. Guadalajara is not suffering from the kind of mortgage crisis that has depressed prices in many parts of the US. Indeed, the local market can best be described as a slowly deflating soccer ball rather than a bursting "bubble."

AGRICULTURE: "People Gotta Eat, But~~."

¶7. Commercial agriculture has long been a mainstay of the economy in western Mexico, and tends to be more stable than other sectors because demand for food products is less elastic than for many other goods. Exports of avocados, mangoes, and citrus fruit (reftel) are a real success story, earning over US\$850 million in 2008, with good prospects for future growth. On the other hand, agricultural imports (principally from the United States) have been negatively affected by the decline of the peso, and by new tariffs imposed on products such as grapes, pears, and cherries in retaliation for the US decision to bar Mexican trucks. Local producers who rely on imported inputs (such as feed grains, oil seeds, or fertilizer) have also seen their cost of production rise in recent months, leading to reduced purchases. The Guadalajara office of the American Soybean Association reported a 19 percent decline in soybean exports to Mexico so far this year, as well as a 23 percent drop in soybean oil sales (partially offset by a 22 percent rise in soy meal exports). On the plus side, western Mexico also continues to attract foreign investor interest in non-traditional crops, such as winter vegetables, cherry tomatoes, and ornamental plants.

TOURISM: Good Deals vs. the Fear Factor

¶8. While the decline of the peso makes vacations to beach resorts in cities such as Puerto Vallarta, Manzanillo, and Mazatlan attractive to foreign visitors, the media coverage of narco-inspired violence in other parts of Mexico, as well as rising unemployment and economic problems in the United States, have combined to counteract much of the price benefit. Pacific Airports Group (GAP) reported an 8 percent decline in international traffic at the 12 airports it manages in western Mexico, and Jalisco Secretary of Tourism Aurelio Lopez Rocha conceded that the State fell short of its 2008 goals both in numbers of tourists attracted and the amount of income generated. Initial reports indicate that the number of Spring Break visitors this year will also be below last year's level. Hotel occupancy rates have dropped, but according to an executive at one major national chain, the decline in western

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Mexico is less steep than in cities like Monterrey, which are more dependent on business travel. Some bright spots in the sector include the start-up of a new regional airline based in Guadalajara, Mexicana Link, as well as the decision by a Spanish company to homeport a cruise ship in Puerto Vallarta beginning in May.

¶9. Northbound travel has been severely affected by the exchange rate and economic crisis. The number of visa cases processed in Guadalajara in the first three months of 2009 was approximately 20 percent lower than the same period last year. Delta Airlines temporarily suspended its Los Angeles flight, and several other carriers have reduced capacity on routes between Guadalajara and the United States.

RESTAURANTS AND SCHOOLS: Mixed Signals:

¶10. The contracting economy has also had a negative impact on

the restaurant sector, with overall sales down by about 15 percent according to the Jalisco Restaurant Association. The declining peso has affected US franchise holders, such as Outback and Carl's Jr, which import the majority of their main ingredients from the United States. Their owners, while working to cut costs, are also guardedly optimistic about their future prospects. Outback, for instance, opened its fourth and largest restaurant in Guadalajara's newest and most upscale mall last December. Private schools and universities so far have seen only a small number of departures due to economic issues, and competition for enrollment in expensive institutions like the American School Foundation of Guadalajara remains keen.

COMMENT: Riding Out the Storm

¶11. Despite the economic turbulence, there are no signs of panic in the local business community. Both the high-tech and agricultural sectors are continuing to attract investor interest, with encouragement from the various state and local governments in the region. Nevertheless, business leaders continue to cast a wary gaze northward, both to the violence-plagued frontier and to developments in the United States itself. More bad news on the security front could further undermine a weakened tourist industry and discourage foreign investment, thereby costing thousands of jobs. The anemic US economy has depressed demand for Mexican exports such as furniture, and the depreciated peso plus new punitive tariffs are hurting US exports to one of America's best customers. A further decline in remittances from Mexicans in the United States would also hurt the region. While belt-tightening is the order of the day in most economic sectors here, it has so far been gradual and orderly. Barring any unexpected sudden shocks, most observers expect it to remain that way until a global economic recovery begins.

RAMOTOWSKI